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UNCLAS SECTION 01 OF 05 BRASILIA 001276

SIPDIS

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H-PASS  
FROM CHARGE CHICOLA FOR CODEL CORNYN

E.O. 12958: N/A  
TAGS: [PGOV](#) [ECON](#) [BR](#)  
SUBJECT: SCENESETTER FOR THE VISIT OF CODEL CORNYN

¶1. (SBU) The United States Mission in Brazil warmly welcomes your planned July 1-3 visit to Foz de Iguacu. Consul General McMullen will greet you in Sao Paulo, and he and his team will brief you on your program. In addition, our DEA Country Attache and our Acting DHS Attache will brief you on the full range of law enforcement issues they confront.

¶2. (SBU) Your trip comes at a transition point on the political scene. During the second semester of 2005, congressional deputies from Lula's governing coalition were accused of accepting bribes, while officials from the President's party (the PT) were alleged to have engaged in influence-peddling and illegal campaign fund-raising. These revelations forced the resignation of several members of Lula's inner circle, including his former Chief of Staff (who was also expelled from Congress).

¶3. (SBU) However, "scandal fatigue" has set in, and President Lula has successfully used the slack time to recover lost political ground. Recent polls show Lula regaining the lead in the presidential race, and he is currently engaged in a busy schedule of visits around the country - campaigning in all but name - while the leading opposition candidate from the PSDB party has stalled in the polls. The election campaign will commence in earnest after the World Cup ends July 9 - Brazilians expect that their squad will be in the finals - with presidential and congressional elections set for early October.

#### THE BILATERAL RELATIONSHIP

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¶4. (SBU) While relations between the U.S. and Brazil are friendly, often the USG encounters major difficulties in gaining the cooperation of senior policymakers on issues of significant interest to the United States. Eager to assert its own influence, the Brazilian government shies away from cooperation with the USG - unless it can clearly be characterized as a reciprocal exchange among equals. Indeed, hyper-sensitivity on issues viewed as infringing on Brazil's sovereignty can get out of hand and may be seen as signs of political immaturity. Many Brazilians believe the U.S. has designs on the Amazon. Our fingerprinting of visitors to the U.S. drew reciprocal treatment for Americans here; visa and immigration issues remain sensitive points.

¶5. (SBU) During recent months, our ongoing dialogue with the Brazilians has focused on a variety of potentially useful projects for both sides. We sought to interest the GOB in a Defense Cooperation Accord, but the Foreign Ministry rejected the proposal even though the Defense Ministry was supportive. Gaining agreement on privileges and immunities to be granted U.S. servicemen engaging in military exercises has been just as tough, as the Foreign Ministry saw it as "a foot in the door" and linked it with Brazil's

strong opposition to Article 98 agreements. We are receptive to renegotiation of a stalled bilateral agreement governing space launches at the country's equatorial base at Alcantara, but the GOB has moved glacially to re-engage, even though the agreement clearly serves Brazilian interests. On trade issues, when unscripted, President Lula has characterized the FTAA as "off his agenda." IPR is another sore point, as it has become clear that the USG and the Brazilian government have different views on the degree of protection to be afforded to intellectual property. Only after much lobbying have we gotten the GOB to: a) turn the corner on copyright piracy, and b) pursue negotiated solutions rather than compulsory licensing of AIDS anti-retrovirals.

¶6. (SBU) However, not all our conversations are difficult. At the personal level, Lula has met President Bush several times and the two have a good rapport. On issues involving matters perceived as technical in nature - i.e., law enforcement and science (but not counter-terrorism) - the GOB is eager to engage. For example, from 2003 to 2004, the GOB worked quietly with us on the timing and details of its counter-drug shoot-down program to accommodate our statutory requirements. Brazil's Ministry of Health has expressed its desire to expand the collaboration they have with the U.S. Centers for Disease Control and the National Institutes of Health as these agencies work within the Brazilian medical community to bring newer treatments and technologies. The Brazilians have also eagerly participated in the dialogue leading up to the first meeting of a bilateral commission on science and technology, scheduled for July 2006, in Washington.

¶7. (SBU) On development assistance issues, our dialogue is positive, but constrained. Notwithstanding lackluster results to date, the Brazilian government's multi-billion dollar poverty alleviation program - Zero Hunger - receives substantial funding from the World Bank and IDB. Given USG budget constraints and the

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fact that Zero Hunger is, in essence, a cash transfer program (albeit with conditions), USAID support has been limited. Instead of focusing on cash transfers to the poor, USAID has sought to target its efforts towards promoting sustainable livelihoods - inter alia, through working with small and medium-sized enterprises. The Embassy's Public Affairs programs are aimed at promoting young leaders take a similar targeted approach. This difference in focus, broad cash transfers versus targeted assistance, ends up putting the USG at the margins of Brazil's overall anti-poverty efforts.

#### COUNTER-DRUG EFFORTS

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¶8. (U) While not a significant drug-producing country, Brazil is a conduit for cocaine base and cocaine HCl moving to Europe, the Middle East and Brazilian urban centers, as well as a conduit for smaller amounts of heroin moving to the U.S. and Europe. Cocaine and marijuana are used among youth in the cities, particularly Sao Paulo and Rio de Janeiro. Organized drug gangs are involved in narcotics related arms trafficking.

¶9. (U) U.S. counternarcotics policy in Brazil focuses on working with Brazilian authorities in identifying and dismantling international narcotics trafficking organizations, reducing money laundering, increasing awareness of the dangers of drug abuse and drug trafficking and addressing related issues such as organized crime and arms trafficking. Other key goals include assisting Brazil in developing a strong legal structure for narcotics and money laundering control and enhancing cooperation at the policy level. Bilateral agreements provide cooperation between U.S. agencies, the National Anti-drug Secretariat and the Ministry of Justice. Specifically, the U.S. provided equipment and computers for the coordinated intelligence center in Foz de Iguacu and training courses in airport interdiction and container security.

¶10. (U) Brazil's first line of defense against drug smuggling is enforcement at its heavily transited border crossings. Drug traffickers exploit the expansive border in areas where Brazilian law enforcement has only a minimal presence. To more effectively combat trans-border trafficking organizations, Brazil is cooperating

closely with its neighbors by establishing joint intelligence centers (JIC). The newest JIC is planned for the Brazilian/Bolivian border.

¶11. (U) The GOB has begun to institutionalize its National Strategy for Combating Money Laundering (ENCLA), holding its third annual high-level planning session in December 2005. Also in 2005, the GOB drafted, but has not yet presented to Congress, a bill updating its anti-money laundering legislation. If passed, this legislation would facilitate greater law enforcement access to financial and banking records during investigations, criminalize illicit enrichment, allow administrative freezing of assets, and facilitate prosecutions of money laundering and terrorist financing cases.

¶12. (U) Brazil's Unified Public Safety System (SUSP), created in 2003, is now fully functional and showing results. SUSP, which is administered by the Brazilian National Public Safety Secretariat (SENASP), is a national system to integrate diverse state, civil and military police forces. Collaboration between SENASP and NAS has been good. A number of courses, including crisis management, training for counternarcotics SWAT teams, and training for dog handlers, were sponsored by NAS and hosted by SENASP for state law enforcement officials throughout Brazil.

FOREIGN POLICY

¶13. (SBU) Reflecting Brazil's ambivalence towards the United States, President Lula has run an activist foreign policy with a focus on South America and the Third World, seeking to forge alliances with other large and mid-sized powers (South Africa, India, etc.). He has traveled extensively in pursuit of a higher international profile for Brazil. Despite prodding from the USG and others, Lula has refused to condemn Cuba for human rights violations and, in fact, has pushed for Cuban membership in the Rio Group. Brazil has also advocated a Cuba-Mercosul trade pact. The GOB has worked to increase both its economic and political ties with Venezuela. It has agreed to upgrade Venezuela from associate membership to full membership status in Mercosul, and enhanced integration of the two countries' energy sectors is high on its agenda. Lula has been especially solicitous of Chavez. He has praised the Venezuelan President's democratic credentials ("if anything, Venezuela has an excess of democracy") and declared that the Chavez government had been demonized by its foes. However, Venezuela's apparent involvement in Bolivia's recent decision to nationalize that country's oil and gas industry has dulled the luster on this relationship.

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¶14. (SBU) Given its size and natural resources, Brazil has long seen itself as the natural leader of the region (even though that perception is not shared by its neighbors). Brazil's reaction to Bolivia's recent nationalization of foreign petroleum installations in that country is a case in point. Shocked that the Bolivians viewed the Brazilian oil parastatal Petrobras as a "boss, not a partner," government policymakers have vacillated in response to President Morales's threats.

¶15. (SBU) Emblematic of Brazil's efforts to gain greater standing on the world stage is its tenacious pursuit of a permanent UN Security Council (UNSC) seat. In fact, many observers point out that Brazil has "subordinated" other economic and political interests with such countries as China and Russia in exchange for support (which has not been forthcoming) for its UNSC aspirations. Brazil and other G4 states (India, Germany, Japan) are, despite recent setbacks, continuing to press their campaign for a vote on a resolution on UNSC reform. This stance is at odds with the position of many Latin American countries, including those which Brazil believes should follow its "natural leadership."

¶16. (SBU) Brazil has long seen international fora as a way to enhance its international stature. Reflecting this, in 2005 it launched failed national candidates for the top jobs at both the WTO and the IDB. The failure of both, together with the unlikely prospects for a permanent seat in the UNSC, has widely been seen in Brazil as a "political disaster."

PRESIDENT LULA

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¶17. (SBU) President Luiz Inacio Lula da Silva was inaugurated in January 2003 after a career as a Sao Paulo metalworker and labor leader. He founded the left-of-center Workers' Party (PT) in 1980 and lost three presidential campaigns before winning in the October 2002 elections. Lula is eligible to run for reelection in October ¶2006. Elected in large part on promises of promoting an ambitious social agenda, including a "Zero Hunger" program, Lula's government has failed to deliver much in this area, as managerial shortcomings and the public's top concern - crime and public security - have not improved under this administration.

¶18. (SBU) As noted above, the Lula Administration has been beset by a grave political crisis as interlocking influence peddling/vote-buying scandals plagued elements of Lula's PT party. During the second half of 2005, the crisis placed Lula on the defensive and politics were dominated by investigations, accusations, and revelations. The President's Chief of Staff resigned his post and was later expelled from Congress. Meanwhile, several other Congressmen were the subjects of investigations and expulsion proceedings owing to bribery allegations. In April 2006, the President's influential Finance Minister was forced to resign (and remains under criminal investigation) because of unrelated abuse of power allegations. Thus far, Brazilian society - including the opposition - seems disinclined to hold Lula personally responsible for the scandals, and he has recovered lost ground in public opinion and holds a comfortable lead in the polls over his principal opponent in the presidential contest.

#### MACRO-ECONOMIC DEVELOPMENTS

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¶19. (SBU) President Lula and his economic team have implemented prudent fiscal and monetary policies and pursued necessary reforms. Brazil's external accounts, aided by a benign international environment, have improved substantially over the last three years. Although GDP growth dropped to 2.3% in 2005, down from a strong performance (4.9%) in 2004, Brazil has experienced booming exports, healthy external accounts, inflation under control, decreasing unemployment and reductions in the debt-to-GDP ratio. Economic activity should pick up in 2006; the markets expect GDP growth of about 3.5%. Buoyed by exports and investment inflows, the Real has remained at appreciated levels, allowing the government and businesses to pay down external debt. The government pre-paid its IMF obligations, its last remaining rescheduled Paris Club obligations, and in April 2006 announced it had retired the last of its Brady bonds. This removes from the books all restructured debt associated with Brazil's late-1980's default. Based upon the improving external debt dynamics, Fitch IBCA upgraded its credit rating on Brazil's sovereign debt in February 2006, to BB (two notches below investment grade). The economy also has shown resilience, remaining for the most part unaffected by a major political scandal and the replacement of the Finance Minister.

¶20. (SBU) Despite this considerable progress, key challenges

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remain. The public sector debt-to-GDP ratio is on a downward trend but remains high, at about 51.6%. Real interest rates are among the highest in the world; reducing them will require both reductions in the government's borrowing requirement and reform of the financial sector and the judiciary. Income and land distribution remain skewed. Investment and domestic savings are low, although growing. The informal sector constitutes between 35 to 40 percent of the economy, in part because the tax burden (nearly 38 percent of GDP) is high.

¶21. (SBU) Sustaining high growth rates in the longer term depends on the impact of President Lula's structural reform program and efforts to build a more welcoming climate for investment, both domestic and foreign. In its first year, the Lula administration passed key tax and pension reforms to improve the government fiscal accounts. Judicial reform and an overhaul of the bankruptcy law, which should improve the functioning of credit markets, were passed in late 2004, along with tax measures to create incentives for

long-term savings and investments.

¶22. (SBU) Public-Private Partnerships, a key effort to attract private investment to infrastructure, also passed in 2004, although implementation of this initiative still awaits promulgation of the necessary regulations. Labor reform, additional tax reform, and autonomy for the Central Bank were on the agenda for 2005, but now look unlikely to be addressed at least until after the October 2006 elections. Much remains to be done. The government needs to improve the regulatory climate for investment, particularly in the energy sector; to simplify torturous tax systems at the state and federal levels; and to further reform the pension system.

#### TRADE POLICY

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¶23. (SBU) To increase its international profile(both economically and politically), the Foreign Ministry (Itamaraty) is seeking expanded trade ties with developing countries, as well as strengthening the Mercosul customs union with Uruguay, Paraguay and Argentina. Arguably the GoB has fallen short on this latter objective. The Brazil-Argentina relationship is rife with trade disputes, recently leading to adoption of a safeguard mechanism for bilateral trade. Meanwhile, Uruguay and Paraguay regularly complain that Brazil and Argentina reap a disproportionate share of benefits from the bloc, and threaten the group's solidarity in various ways -- for instance, Uruguay's recent discussions with the United States regarding a possible FTA (which would contravene Mercosul rules).

¶24. (SBU) Nonetheless, the bloc remains engaged in certain external trade negotiations. In 2004, Mercosul concluded free trade agreements with Colombia, Ecuador, Venezuela and Peru, adding to its existing agreements with Chile and Bolivia to establish a commercial base for the newly-launched South American Community of Nations. As noted earlier, Mercosul is upgrading Venezuela's status from associate to full membership. In addition to Cuba, the bloc is currently exploring free trade talks with Israel, the Dominican Republic, Panama and states of the Gulf Cooperation Council, as well as trying to build on partial trade liberalization agreements concluded with India and South Africa in 2004.

¶25. (SBU) China, which was offered market economy status by Brazil as a part of Lula's effort to secure PRC support for Brazil's bid for a USNC seat, has increased its importance as an export market for Brazilian soy, iron ore and steel, becoming Brazil's fourth largest trading partner and a potential source of investment. However, low-priced Chinese imports, particularly in the textile, footwear, and toy sectors, are now threatening to displace domestic Brazilian production. As many Brazilian observers have indicated, all this effort is aimed at countries which together represent less than a third of Brazil's foreign trade. Free trade negotiations with the EU continue to languish.

#### DOHA AGENDA - WTO

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¶26. (SBU) While Brazil emphasizes South-South trade through Mercosul's bilateral negotiations, it uses the Doha Development Agenda (DDA) negotiations as the main forum for engaging with developed country partners. The DDA is Brazil's top trade priority, viewed as the last chance for perhaps 15-20 years to secure fundamental changes in international trade rules, in particular, for international agricultural trade. Brazil leads the G-20 group of developing countries that is pressing for agricultural trade reform in the DDA. Brazil's assertive leadership of the G-20 was blamed in some quarters for causing the failure of the WTO Cancun Ministerial in September 2003. Since then, Brazil has been more constructively

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engaged in the Doha Round, initially as a member of the "Five Interested Parties" and more recently G-6 informal group, although many of its positions are still at odds with U.S. interests. At the December 2005 Hong Kong Ministerial meeting, Brazil was key to brokering the deal - albeit one of limited ambition - coming out of that session. Brazil can be expected to maintain its assertive stance in the Doha Round on agricultural trade reform while taking



more defensive postures in the discussions covering industrial products and services.

#### FREE TRADE OF THE AMERICAS - FTAA

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¶27. (SBU) As indicated above, the Lula Administration shows no serious interest in pursuing the FTAA. Despite serving as co-chair and having secured in the November 2003 Miami meeting a new framework for negotiation, Brazil has shown no inclination to move the process along and has so far declined to convoke the next FTAA Ministerial - which is now overdue.

CHICOLA